In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-871

NEW JERSEY CHAPTER INCORPORATED OF THE AMERICAN PHYSICAL THERAPY ASSOCIATION, INC., PETITIONER

v.

CASPAR W. WEINBERGER, SECRETARY OF HEALTH, EDUCATION AND WELFARE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

---

1. Petitioner, an association of physical therapists, instituted this action to challenge the validity of certain guidelines employed by the respondent, the Prudential Life Insurance Company of America ("Prudential"), to determine the "reasonable cost" of physical therapy services under the Medicare Act, 42 U.S.C. 1395, *et seq.* Petitioner's members supply physical therapy services to extended care facilities which qualify as "providers of services" under the Act. Such "providers" are entitled by the Act to be reimbursed for the "reasonable cost" of the services they furnish to Medicare beneficiaries (42 U.S.C. 1395f). Determinations of the reasonableness of the costs of providers are frequently made by "intermediaries", which are usually private

organizations with experience in the health care field and which have entered into agreements with the Department of Health, Education and Welfare (42 U.S.C. 1395h). The respondent Prudential is a qualified intermediary under the Act.

In 1969, the Bureau of Health Insurance—the agency within HEW which administers the Medicare program—issued Intermediary Letter No. 393 (IL 393) articulating the "prudent buyer" concept. That letter stated that providers were expected to act as "prudent buyers" in purchasing medical services, and that intermediaries should disallow costs which are in excess of that standard.[1] Pursuant to the prudent buyer concept, Prudential, on November 23, 1971, issued guidelines for evaluating the reasonableness of costs incurred by providers for physical therapy services. Under these guidelines, a provider's cost for independent therapists, such as petitioner's members, would automatically be treated as reasonable if it did not exceed the cost that would have been incurred if the provider's own employee performed the service plus the cost of reasonable expenses incurred by the independent therapist. The court below found that costs in excess of this salary equivalence standard would also be reimbursed, if the particular circumstances of the provider justified the additional cost. However, the burden of proof was upon the provider to demonstrate that he acted as a prudent buyer in incurring the higher cost (Pet. App. B 10a).

In 1972, the petitioner instituted this suit in the district court, challenging the validity of Prudential's guidelines on the ground, *inter alia,* that Prudential had

---

[1]The letter stated that "The prudent and cost-conscious buyer not only refuses to pay more than the going price for an item or service, he also seeks to minimize costs * * * " (Pet. 6).

promulgated a regulation without notice and opportunity for hearing as required by the Administrative Procedure Act (A.P.A.), 5 U.S.C. 553. The district court dismissed petitioner's complaint for lack of standing (Pet. App. A 1a-2a). The court of appeals, expressing doubt on the standing and judicial review issues, affirmed on the merits (Pet. App. B 2a-11a). It held that Prudential's guideline letter "was not a regulation but was merely an explanation or interpretation of the reasonable cost limitation found in the Medicare Act" (Pet. App. B 10a).

2. The decision of the court below is plainly correct and there is no conflict of decisions. Moreover, the issue of Prudential's authority to issue the challenged guidelines is without prospective importance since in 1972, subsequent to the commencement of this litigation, Congress amended the Medicare Act to require a salary equivalence scale in determining reimbursable costs for physical therapy services. 86 Stat. 1445, 42 U.S.C. (Supp. II) 1395x(v)(5). On February 7, 1975, the Secretary of Health, Education and Welfare promulgated regulations implementing this statutory provision (40 Fed. Reg. 5760-5762, 5810), thus superseding the challenged guidelines applied by Prudential.

a. Contrary to petitioner's contention (Pet. 10) that Prudential's guideline letter constituted an HEW regulation, the court of appeals properly held that the letter was simply an interpretation or explanation of the reasonable cost limitation of the Act, and hence was in any event exempt from the notice and hearing requirements of the A.P.A. (see 5 U.S.C. 553(b)(A)).[2]

---

[2]The court stated that it made this ruling "[w]ithout intimating that Prudential is an 'agency' within the meaning of the Act, 5 U.S.C. § 551(1)" (Pet. App. B 10a).

Under the Medicare Act, intermediaries such as Prudential are charged with applying the reasonable cost limitation in determining the amounts of payments to providers (see pp. 2-3, *supra*). In making these determinations, they have been instructed by the Bureau of Health Insurance to assure that providers act as prudent buyers in obtaining medical services for Medicare beneficiaries. Prudential is thus under a statutory and administrative obligation to apply these requirements when evaluating the cost of the various services furnished by providers. The challenged guidelines represent Prudential's interpretation of these requirements with respect to physical therapy costs, and its guideline letter, as the court below held, served the purpose of explaining to providers the manner in which Prudential would henceforth determine the amount payable for physical therapy services (Pet. App. B 10a). The court of appeals thus properly held that a hearing was not required under the A.P.A.

b. Petitioner also argues (Pet. 11-12) that even if Prudential's guidelines are properly regarded as an interpretation of the Act, Prudential is nonetheless precluded from developing methods for determining reasonable costs. However, as we have shown, Prudential is under a statutory duty to determine reasonable costs, and Congress can hardly have intended to prohibit intermediaries from developing a rational means of doing so.[3]

---

[3]There is no merit to petitioner's contention (Pet. 16-18) that the court of appeals improperly resolved disputed issues of fact without a trial. Petitioner's argument is focused upon the statement of the court of appeals that "Prudential will continue to allow all costs that are reasonable" (Pet. App. B 10a). Petitioner maintains that the burden of proof upon providers to overcome the salary equivalence scale will be a difficult one, and, therefore, "the application of the sliding scale will be the norm" (Pet. 18).

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

MARCH 1975.

But the court's statement was not a factual prediction as to the frequency of deviations from the scale. It was an interpretation of Prudential's guidelines and subsequent explanatory letter (see Pet. App. B 6a-7a, 10a). This was within the appellate court's proper function. It is, moreover, clear that Prudential did agree to approve costs in excess of the guidelines if providers showed them to be reasonable (*ibid.*).